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Supreme Court of the United States

October Term, 1927

No. 5[redacted] 16

ELIZABETH C. TAFT, *Petitioner,*

vs.

FRANK K. BOWERS, Collector of Internal Revenue for the Second District of the State of New York,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

SUPPLEMENTAL BRIEF FOR THE PETITIONER

CADWALADER, WICKERSHAM & TAFT.

HENRY W. TAFT,
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No. 554

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vs.

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

SUPPLEMENTAL BRIEF FOR THE PETITIONER

This brief is filed to show:

(1) That no part of a gift constitutes, within the meaning of the Sixteenth Amendment, income of a donee; and

(2) That it was not the intention of Congress to give to Section 202 (a) (2) of the Revenue Act of 1921 a retroactive effect so as to take account of increase in the value of the gift accruing prior to the passage of the law.

A.

A gift is not income.

The Government's argument is:

(a) In "ordinary sense" and in "common speech" a gift is income. Congress regarded it as such because it specifically provided that it should be exempted from gross income.

(b) If the entire value of the gift is taxable, a part of it, to-wit, the enhancement of its value from the time the donor acquired it, is taxable.

This narrows the controversy to the question whether a gift is income within the meaning of the 16th Amendment.

Preliminarily, it may be said that Congress cannot by legislation convert into income what is not income. Furthermore, the proviso relied upon by the government, that the value of property acquired by gift should be exempt from taxation, has no such effect as that claimed. The office of a proviso is to "remove possible obscurities that might otherwise exist and render the law more precise" (Sutherland, Statutes and Statutory Construction, § 216) or "to exclude some possible ground of misinterpretation of it, as extending to cases not intended by the legislature to be brought within its purview." (*American & English Enclopaedia of Law,* 2nd edition, p. 678, quoted in *Matter of Hoss,* 59 Washington, 360). It is quite natural that Congress should intend to remove any ambiguity upon the subject of what was and what was not income, since it has excited so much controversy and difference of opinion among lawyers and the courts. No reasonable argument, therefore, can be based upon the exemption referred to.

Argument.

Neither in "common speech" nor in the "ordinary sense" is a gift income.

1. That it is a "gain" does not settle the question, for the 16th Amendment refers only to "incomes", and we are, therefore, thrown back to the question, what is an "income"?

2. The word "income" does not in any of its uses or any of its meanings, direct or derivative or implied, include a gift.

This question should be considered by looking at it from a variety of viewpoints, even though from no one of them alone is a conclusion to be drawn. A correct definition will result from a composite view:

(a) Etymological:

The New Standard Dictionary gives the meaning of "income" as follows:

> "The amount of money coming to a person or corporation within a specified time or regularly (when unqualified, annually), whether as payment for services, interest from investment; revenue."

None of the other meanings given to the word depart in essence from the foregoing definition.

The meaning given for the word "capital" gives the relation between "capital" and "income" as follows:

> "(1) The property used in the business of a firm or corporation at a valuation on which profits or dividends are calculated. * * *
>
> "(3) The amount of property owned by an individual or corporation at a specified time, as distinct from the income received during a given period."

The definition in the Oxford Dictionary of "income" is as follows:

> "That which comes in as the periodical produce of one's work, business, lands, or investments (considered in reference to its amount, and commonly expressed in terms of money): annual, or periodical receipts accruing to a person or corporation."

From these definitions it is to be noted:

(1) Income comes to a person "within a specified time" or "regularly", or is the "periodical produce" or the "annual, or periodical receipts." This language would exclude a gift or a legacy or an inheritance, all of which are casual, come without regularity, or in the case of capital increase, during a definite period.

(2) Income must be "as payment for services, interest from investment; revenue", or "produce of one's work, business, lands, or investments."

While the definition of income has been extended by the Income Tax Law and the decision of this Court in *Merchants Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509, so as to include accretion to capital, that decision was rendered with reference to an accretion which was a realized "gain or profit", "produced by" or "derived from" an *investment;* but the words used in *Stratton's Independence* v. *Howbert* (231 U. S. 399, 415), and applied in *Doyle* v. *Mitchell Bros. Co.* (247 U. S. 179, 185), which were approved as to the Income Tax Law in *Eisner* v. *Macomber* (252 U. S. 189), and *Merchants Loan & Trust Co.* v. *Smietanka* (255 U. S. 509), do not affect the essen-

tial features of an income that it (1) must be the product of invested capital or labor or services, and (2) must be reckoned for regular periods (annually, if not specified otherwise), or within some definite or specified period, as, for instance, the period during which a realized gain upon an investment is to be measured.

(b) Income in Its "Ordinary Sense" or in "Common Speech".

We quote some expressions of the courts upon this subject:

Justice Holmes in his dissenting opinion in *Eisner* v. *Macomber, supra,* said that income should be read " 'in a sense most obvious to the common understanding at the time of its adoption.' "

Justice Clark in *Merchants Loan & Trust Co.* v. *Smietanka, supra,* said income should be given the "commonly understood meaning" in the minds of the people.

Judge Learned Hand, for the Circuit Court of Appeals for the Second Circuit, in *United States* v. *Oregon-Washington R. & Nav. Co.,* 251 Fed. Rep. 211, used the following language:

> "Yet the word unquestionably imports, at least so it seems to us, the current distinction between what is commonly treated as the increase or increment from the exercise of some economically productive power of one sort or another and the power itself, and it should not include such wealth as is honestly appropriated to what would customarily be regarded as the capital of the corporation taxed.
>
> • • • • • •
>
> We regard the difference as precisely equivalent to the difference between the cancellation of a portion of the mortgage bonds and a cancellation

> of an equal proportion of their coupons. Common usage would, if we are right, unfailingly allocate the first as an increase in capital assets and the second as an increase in income. That, as we view it, is the proper test of the act."

We will consider the meaning of income in "common speech" in a number of relations. But first, what is "common speech"? It must be presumed that it is the speech which members of Congress consider appropriate to express their meaning. That involves the exercise of some intelligence and experience. A meaning ought not to be given to a statutory expression because the ignorant, the uneducated and the inexperienced would give it that meaning. We do not look to persons in the community, however numerous, for a definition of a word defining something which they have never had occasion to deal with. This is a reasonable position from which to consider the significance of income in what the court has called "common speech."

(1) *The Man in the Street:* He would regard a gift, a legacy, a devise or an inheritance as a windfall—as a nest-egg to be added to his savings. Any individual member of Congress with business experience, would also regard it in that light.

(2) *Economists* (as quoted in the opinion in *Eisner* v. *Macomber*): Capital is "likened to the tree or the land", income "to the fruit or the crop"; capital as the "reservoir supplied from springs", income "as the outlet stream, to be measured by its flow during a period of time."

(3) *Accountants and Businessmen:* Clearly a gift would be treated as an accretion of capital. For instance,

a father puts a son in a business firm and presents him with a sum of money for that purpose. It goes into the capital account of the son, and usually he is allowed interest upon it, which, of course, is his income. A father pays for a son's seat in the Stock Exchange, the seat to be used for the business of a firm which the son enters. The amount paid for the seat, of course, goes to the capital account of the son.

(4) *Contribution of a Stockholder to a Corporation:* A stockholder contributes stock or bonds or cash in order to increase the value of the stock he continues to hold. The contribution increases the assets of the corporation and would, of course, go into its capital account.

(5) *Legacy or Inheritance:* This stands on the same footing as a gift. A legatee or an heir-at-law or next of kin, ordinarily treats a legacy or an inheritance as capital, and if he impairs it in using it, he is regarded as improvident, for it generally represents the accumulation of the ancestor. If a legacy is given to trustees, it is treated as capital on every principle of accounting and law.

In *Irwin* v. *Gavit,* 268 U. S. 161, 166, the effort was made to have a direct bequest of installments of income of a fund left by will in trust, given the character of principal, and, therefore, not subject to the income tax. It was held that the installments were not bequests, but income, "within the meaning of the statute and the Constitution, and by popular speech." Justice Holmes said

> "But we think the provision of the act that exempts bequests assumes the gift of the *corpus* and contrasts it with the income arising from it, but was not intended to exempt income properly

> so called simply because of a severance between it and the principal fund."

Does not this language apply to a gift *inter vivos?* We submit that it does. The statute assumes the gift of the *corpus* and makes the contrast with the income. This contrast results from a fundamental difference. The *corpus* is the entire value of the gift, and Sec. 202 (a) (2) cannot change what was a component part of it from capital into income, whatever the intention was, any more than the testator could by will change what was income into capital. If the gift had been by will to trustees upon a valid trust, they would have been obliged in any probate court to set up the trust at the value at the time that they received it as capital.

This is, as was said in *Eisner* v. *Macomber,* "according to truth and substance, without regard to form." And it is added:

> "Congress cannot by any definition it may adopt conclude the matter, since it cannot by legislation alter the Constitution, from which alone it derives its power to legislate, and within whose limitations alone that power can be lawfully exercised."

B.

A gift is not income within the definition approved by this Court.

A definition of income was first given under the Corporation Tax Law of 1909 in *Stratton's Independence* v. *Howbert* (*supra*); *Doyle* v. *Mitchell Bros. Co.* (*supra*). It was:

> "Income may be defined as the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets."

This definition was adopted by the Court in *Eisner* v. *Macomber*, in the words, "we find little to add to the succinct definition adopted" in those two cases. The only amplification of the definition made by this court was made in the *Doyle* case to the effect that it conveyed "the idea of gain or increase arising from corporate activities" and that it imports "something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax." This definition is predicated on the taxable income being produced by labor or services of the taxpayer, or proceeding from the use of property; as was said in the *Macomber* case, it is not mere "gain" or accession, it must be a gain or accession "derived" or proceeding from existing capital, presumably capital in which the taxpayer has an interest as owner or otherwise. A gift does not proceed from capital nor is it derived from capital or labor or both capital and labor combined. It simply comes to the taxpayer without labor on his part and without the use of his capital.

C.

That it was not the intention of Congress to give to the amended Section 202 (b) (3) of the Revenue Act a retroactive effect so as to take account of increase in the value of the gift accruing prior to the passage of the law.

We suggest that Section 202 (a) (2) of the Revenue Act of 1921 may be so interpreted as to grant relief to this petitioner and at the same time avoid an unconstitutional result.

It is an established rule of statutory construction that if two interpretations are possible, the Court will adopt the one that avoids an unconstitutional result. It is equally well established that this Court will not adopt an interpretation which gives a retroactive effect to a statute, unless the language is so clear, strong and compelling that such an interpretation is imperative. *Shwab* v. *Doyle*, 258 U. S. 529; *White* v. *United States*, 191 U. S. 545.

As applied to the present petitioner, the interpretation placed by the Circuit Court of Appeals on Section 202 (a) (2) of the Revenue Act of 1921 has a retroactive effect. The donor acquired the stock, which was the subject of the gift, in the year 1916 (Rec. 4). He gave part of it to the petitioner in December, 1921, and part in January, 1922. The parties have agreed that the value of the stock as of the date of gift was $11,708.80 (Rec. 4). The record also accepts the cost to the donor in 1916 as zero (Rec. 4). Therefore it follows that since the statute as interpreted by the Court below has taxed the full amount

of the proceeds of the sale to the petitioner, it has reached back and taxed an increment which occurred prior to December 31, 1920, and prior to the date of the passage of the Revenue Act of 1921, which was November 23, 1921; and the statute would necessarily have the same effect in every case where the acquisition of the property by the donor was prior to the date of the Act and the increment occurred prior to that time. We insist that the language of Section 202 (a) (2) is not sufficiently strong and clear to compel such a construction, and we suggest that a proper interpretation of the section is that it applies only in those cases where the donor acquired the property subsequent to December 31, 1920, and the gift was made after that date. So interpreted, the statute is given a reasonable effect and does not reach an increment that accrued prior to the passage of the Act.

The fact that under the foregoing interpretation the statute provides no basis for determining gain or loss in the present case ought not to cause any difficulty, for prior to the Revenue Act of 1921 there was no provision in any of the Income Tax Acts fixing a basis for determining the gain or loss on the sale of property acquired by gift. The Department found no difficulty under the wording of the statutes in providing by regulation that the basis should be the fair market value on the date of acquisition (U. S. Treasury Regulations 33, Rev. Art. 4; U. S. Treasury Dept. Regulations 45, Art. 1562, issued under the Income Tax Acts prior to 1921), and this position of the Department has been upheld by the courts. *Rice* v. *Eisner* (16 Fed. 2d, 358). Such a ruling is as reasonable now as it was then, and we see no reason for not

adopting it in cases like the present, or in other proper cases that may not be strictly within the wording of the section as interpreted above.

Respectfully submitted,

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